(4)

Office - Supreme Court, U. S.
FILED
DEC 1 1942
CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 560

CHARLES T. KLINE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

J. WARREN BROCK,
Counsel for Petitioner.



INDEX

	Page
Petition for writ of certiorari	1
Judgments below	1
Questions presented	2
Statutes and regulations involved	2
Statement	2
Rulings of courts below	7
Reasons for granting writ	7
Brief in support of petition	9
Opinions of the courts below	9
Jurisdiction	9
Statement of facts	9
Questions involved	9
Specifications of errors	9
Argument	10
1. The decision of the Circuit Court in the instant case is probably in conflict with the decision of this Court in Helvering v. Tex-Penn Oil Co., 300 U. S. 481, or with the decision of this Court in Helvering v. Salvage, 297 U. S. 109	9
2. The decision of the Circuit Court in the instant case is in conflict with decisions of other Circuit Courts and the Board of Tax Appeals, (a), following Helvering v. Tex-Penn Oil Co., 300 U. S. 481, or, (b), with such decisions following Helvering v. Salvage, 297 U. S. 109	15
3. The decision of the Circuit Court in the instant case is in conflict, inter alia, (a), with the decisions of the Circuit Courts of Appeals for the Second, Eighth and Ninth Circuits in Bonwit Teller & Co. v. Commissioner, 2 Cir., 53 Fed. (2d) 381, Planter's Operating Co. v. Commissioner, 8 Cir., 55. Fed. (2d) 583, and Belridge Oil Co. v. Commissioner, 9 Cir., 85 Fed. (2d) 762, and (b),	

Page

with its own decisions in Tex-Penn Oil Co. v. Commissioner, 3 Cir., 83 Fed. (2d) 518, (affirmed, 300 U. S. 481), Boggs & Buhl, Inc. v. Commissioner, 3 Cir., 34 Fed. (2d) 859, Pittsburgh Hotel Co. v. Commissioner, 3 Cir., 43 Fed. (2d) 345, and Nichols v. Commissioner, 3 Cir., 44 Fed. (2d) 157.... 16

4. The law with respect to the valuation of corporate stock, subject to restrictive or option agreements, for tax purposes, is in a state of confusion, which will probably result in considerable litigation unless and until the law is clarified by this Court..... 18

5. The decision of the Circuit Court in the instant case is arbitrary and capricious, in that it is not supported by substantial evidence.

Conclusion..... 20

Appendix..... 21

CITATIONS

Cases:

Belridge Oil Co. v. *Commissioner of Internal Revenue*, 9 Cir., 85 F. 2d, 762.....8, 16, 17

Bensel v. *Commissioner*, 36 B.T.A. 246, affirmed, 3 Cir., 100 Fed. (2d) 639..... 16

Boggs & Buhl, Inc. v. *Commissioner of Internal Revenue* (3 Cir., C.C.A.) 34 F. (2d) 859.....8, 16, 17

Bonwit Teller & Co. v. *Commissioner of Internal Revenue*, 2 Cir., 53 F. 2d, 381.....8, 16, 17

Helvering v. *Salvage*, 2 Cir., 76 Fed. (2d) 112; affirmed, 297 U. S. 106, 56 Sup. Ct. Rep. 375, 80 L. Ed. 511..7 8, 13, 15, 16, 18

Helvering v. *Tex-Penn Oil Co.*, 300 U. S. 481, 499, 57 Sup. Ct. Rep.....7, 8, 10, 15, 18

Kopple v. *Commissioner*, 35 B.T.A. 1056..... 15

Lomb v. *Sugden*, 2 Cir., 82 Fed. (2d) 166..... 16

Nichols v. *Commissioner* (C.C.A.) 44 F. (2d) 157...8, 16, 17

Pittsburgh Hotels Co. v. *Commissioner of Internal Revenue*, 3 Cir., 43 F. (2d) 345 (C.C.A. 3).....8, 16, 17

Page

Planters' Operating Co. v. *Commissioner of Internal Revenue*, 8 Cir., 55 F. 2d, 583 ..... 8, 16, 17
Propper et. al. v. *Commissioner*, 2 Cir., 89 Fed. (2d) 617. 15
Tex-Penn Oil Co. v. *Commissioner of Internal Revenue*, 3 Cir., 83 F. 2d, 518, affirmed 300 U. S. 481, 57 Sup. Ct. 569, 81 L. Ed. 755 ..... 8, 16, 20

STATUTES

Revenue Act of 1932, as amended 22
Section 501 (a) 22
Section 501 (b) 22
Section 506 22

REGULATIONS

Regulations 79, (1936 Edition) 22
Article 17 22
Article 19 23



SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 560

CHARLES T. KLINE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The petitioner, Charles T. Kline, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit, entered in the cause between the above-named parties, on September 1, 1942, which judgment affirmed a decision of the United States Board of Tax Appeals.

Judgments Below.

The judgment of the Circuit Court of Appeals, a review of which is sought herein, was entered on September 1, 1942, and is set forth in the Record at page 209.

The decision of the Board of Tax Appeals, which was affirmed by the aforesaid judgment of the Circuit Court of Appeals, was entered on September 25, 1941, and is set forth in the Record at pages 193(a)-200(a).

Questions Presented.

1. In determining the Federal gift tax on petitioner's gift of corporate stock, which involved a determination of the taxable value of said stock, did the Circuit Court give proper effect, if any, to the fact that the stock was subject to a restrictive agreement giving the corporation an option to repurchase the stock at 33⅓ per cent, 50 per cent, or 75 per cent, of its book value, the applicable percentage depending upon the manner of the termination of the petitioner-donor's employment by the corporation?

2. Did not the Circuit Court ignore the uncontradicted and unimpeached testimony of the petitioner's expert witnesses as to the value of the aforesaid stock, and if so, did not its action in so doing constitute reversible error?

3. Is not the valuation of the aforesaid stock approved by the Circuit Court, arbitrary and capricious in that said valuation is not supported by substantial evidence?

Statutes and Regulations Involved.

The statutes and regulations involved are set forth in the Appendix hereto, at page 22.

Statement.

This was a petition to the United States Board of Tax Appeals, wherein the petitioner prayed for a redetermination of his Federal gift tax for the calendar year 1937. The Board sustained the respondent's determination of the said tax, and on appeal, the Circuit Court of Appeals

affirmed the decision of the Board. The essential facts are as follows:

On December 24, 1937, Charles T. Kline, the petitioner in this proceeding, was the owner of a voting trust certificate, evidencing the petitioner's equitable, or beneficial, ownership of 4,500 shares of the common stock, without nominal or par value, of E. J. Lavino and Company, a Delaware corporation. (Stipulation of Facts, [hereinafter called the "Stipulation"], par. 22, R. 32a-35a; Stipulation, par. 32a, R. 40a.) On that date, the shares of stock, represented by the said voting trust certificate, were subject to the terms and provisions of a so-called "restrictive agreement" between the petitioner and E. J. Lavino and Company, dated October 22, 1929. (Stipulation, par. 13-16, R. 24a-27a; the restrictive agreement, R. 15a-18a.)

In the restrictive agreement, it was provided that the petitioner should not sell any of the Company's common stock so long as he remained in the Company's employment, without the consent of the Company. The agreement further provided that during the period of one year after the termination of the petitioner's employment by the Company, the Company should have an option to purchase the petitioner's stock at, (a), 33 1/3 per cent, (b), 50 per cent, or (c), 75 per cent, of its book value as shown on the Company's statement as of the date of the last closing of its books prior to such termination, the applicable per centage was due, (a), to his discharge by the Company for cause, (b), to his resignation *without* the approval of the Company's board of directors, or, (c), to his death, or his resignation *with* the approval of the board of directors.

On December 1, 1937, a regular meeting of the board of directors of E. J. Lavino and Company was held, at which time the said board adopted the following resolution:

> "RESOLVED that there would be no objection on the part of the Corporation to the transfer of common

stock registered in the name of Charles T. Kline, subject to restriction agreement, to Charles T. Kline, Trustee, for the benefit of Ellen S. Kline, *the said stock after transfer to still be subject to the restriction agreement heretofore obtaining*" (Emphasis supplied).

(Stipulation, par. 31, R. 40a; Exhibit 16A, R. 69a-71a.)

On December 24, 1937, the petitioner caused his voting trust certificates, representing his 4,500 shares of the common stock of E. J. Lavino and Company, to be transferred to, and a new certificate to be issued in the name of, "Charles T. Kline, Trustee Under Deed of Trust, Dated December 24, 1937" (Stipulation, par. 32, R. 40a). On the same date, the petitioner executed and delivered an irrevocable deed of trust in which it was recited that the petitioner had caused his voting trust certificate, for 4,500 shares of the common stock of E. J. Lavino and Company, to be transferred into his name as trustee, and the petitioner acknowledged and declared that he held the shares of stock evidenced by the said voting trust certificate, *in trust,* to pay the net income to his wife, Ellen S. Kline, for life, and thereafter, to pay the net income to the petitioner's son, Charles T. Kline, Jr., until he should attain the age of 40 years, and at that time, to pay over and deliver, to his said son, the principal of the trust estate. The deed of trust further provided that if the son died before receiving the principal of the trust estate, the principal was ultimately to be paid to the son's issue, if any, or to the petitioner's wife, or to her appointees by will. The deed expressly declared that the trust therein created was to be irrevocable; the petitioner did not retain, or have any beneficial interest in the trust; and there was no possibility of the trust ever reverting to the petitioner (Stipulation, par. 33, R. 40a-41a; the Deed of Trust, R. 12a-15a).

The date of the last closing of the books of E. J. Lavino and Company, prior to December 24, 1937, was December

31, 1936 (R. 150a-151a), and the book value of the common, no par value stock of the said Company, as shown on its balance shee[1] as of December 31, 1936, was $36.03 (Exhibit 20-A, fourth statement, R. 79a-80a).

In his gift tax return for 1937, the petitioner reported the gift of the 4,500 shares of stock here involved at $57,-073.50, which was intended to represent 33 1/3 per cent of its book value *at December 31, 1936.* This computation was erroneous, the correct book value of the stock at December 31, 1936, being $36.03 per share, or $162,135 for the 4,500 shares, and 33 1/3 of that amount being $54,045. On his return for 1937, the petitioner paid a gift tax in the amount of $243.31.

The respondent increased the taxable value of the stock to $43. per share, this valuation of the stock being explained in the respondent's brief submitted to the Board of Tax Appeals, as follows:

"Common stock, 50,000 shares outstanding $ 500,000.00
Surplus—December 31, 1937 (Ex. 20A) 1,753,779.89

50,000 shares common stock x $45.075 per share (book value) equals	$2,253,779.89
[1] 75% of $45.075 (book value) 12/31/37 per share equals	33.80
Add 75% of three year purchase of excess earnings available on common stock after payment of dividends on these shares	9.48
Total value per share	$43.28

"After taking into consideration all factors involved, the Commisioner determined that the fair market value for gift tax purposes of each share of 'restricted' com-

[1] This refers to footnote in respondent's brief submitted to Board of Tax Appeals not reprinted here.

mon stock of E. J. Lavino & Company owned by the petitioner on December 24, 1937, was $43.00 per share."[2]

At the hearing before the Board, the petitioner called and qualified two expert witnesses to testify as to the value of the common stock of E. J. Lavino and Company on December 24, 1937, if not subject to the provisions of the restrictive agreement, and when subject to its provisions. The first witness testified that the said common stock, if not subject to the restrictive agreement, had a fair market value of $30.90 per share (R. 167a).

The second witness testified that the said common stock, if not subject to the restrictive agreement, had a fair market value within " * * * a low limit of somewheres around 25 and a high limit of somewheres between 35 and 40; but, roughly, I would say that $30. a share was a fair price, all things considered" (R. 177a). However, this same witness also testified, in effect, that when subject to the restrictive agreement, the fair market value of the stock was not in excess of the prices at which the Company could repurchase the stock (R. 178a), and, under questioning by the Board Member, the witness further testified, in effect, that when subject to the restrictive agreement, the stock had no fair market value whatsoever (R. 179a-180a).

The respondent-Commissioner of Internal Revenue offered no evidence as to the value of the common stock of E. J. Lavino and Company, either when subject, or not subject, to the provisions of the restrictive agreement.

---

[2] It will be noted that this determination employs 75 per cent. of book value as of December 31, 1937, to which is added "75% of three year purchase.....9.48." It is submitted that neither of these procedures is authorized by the restrictive agreement or otherwise, and hence, that the determination is arbitrary and capricious.

Rulings of the Courts Below.

The Board sustained the respondent's determination of the petitioner's gift tax for 1937, and, on September 25, 1941, the Board entered its decision determining a deficiency in the petitioner's gift tax, for the said year 1937, in the amount of $13,140.44 (R. 200(a)). In its findings of fact and opinion (R. 193a-199a), the Board utterly ignored the testimony of the petitioner's expert witnesses as to the fair market value of the stock when subject, and when not subject, to the restrictive agreement; it indicated that, in the instant case, the restrictive agreement probably had no effect on the fair market value of the stock; and then, inconsistently, approved the respondent's determination of the value of the stock, in which, it is submitted, the respondent had given a purely arbitrary and capricious effect to the restrictive agreement.

The Circuit Court affirmed the Board's decision (R. 209). In its opinion (R. 203-308), the Court referred to the testimony of the petitioner's expert witnesses, but gave no effect to it. The Court also referred to the restrictive agreement, but, apparently, gave it no effect because it regarded the earning power of the stock as having greater significance. The Court then concluded its opinion by affirming the Board's decision, thus approving the respondent's determination of the value of the stock, which, as is submitted, was arbitrary and capricious.

Reasons for Granting the Writ.

1. The decision of the Circuit Court in the instant case is probably in conflict with the decision of this Court in *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481, or with the decision of this Court in *Helvering* v. *Salvage*, 297 U. S. 109.

2. The decision of the Circuit Court in the instant case is in conflict with decisions of other Circuit Courts and the

Board of Tax Appeals, (a), following *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481, or, (b), with such decisions following *Helvering* v. *Salvage*, 297 U. S. 109.

3. The decision of the Circuit Court in the instant case is in conflict, *inter alia*, (a), with the decisions of the Circuit Courts of Appeals for the Second, Eighth and Ninth Circuits in *Bonwit Teller & Co.* v. *Commissioner*, 2 Cir., 53 F. (2d) 381, *Planter's Operating Co.* v. *Commissioner*, 8 Cir., 55 F. (2d) 583, and *Belridge Oil Co.* v. *Commissioner*, 9 Cir., 85 F. (2d) 762, and (b), with its own decisions in *Tex-Penn Oil Co.* v. *Commissioner*, 3 Cir., 83 F. (2d) 518 (affirmed, 300 U. S. 481), *Boggs & Buhl, Inc.* v. *Commissioner*, 3 Cir., 34 F. (2d) 859, *Pittsburgh Hotel Co.* v. *Commissioner*, 3 Cir., 43 F. (2d) 345, and *Nichols* v. *Commissioner*, 3 Cir., 44 F. (2d) 157.

4. The law with respect to the valuation of corporate stock, subject to restrictive or option agreements, for tax purposes, is in a state of confusion, which will probably result in considerable litigation unless and until the law is clarified by this Court.

5. The decision of the Circuit Court in the instant case is arbitrary and capricious, in that it is not supported by substantial evidence.

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari should be granted.

J. WARREN BROCK,
Counsel for Petitioner.

Dated: December 1, 1942.

